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IN THE
Supreme Court of the United States
OCTOBER TERM, 1982

CONTAINER CORPORATION OF AMERICA,
Appellant,

v.

FRANCHISE TAX BOARD,
Appellee.

On Appeal from the Court of Appeal of the State of California for the First Appellate District

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BRIEF OF THE NATIONAL GOVERNORS' ASSOCIATION AND THE STATE OF HAWAII AS *AMICI CURIAE* IN SUPPORT OF THE *APPELLEE* FRANCHISE TAX BOARD

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INTEREST OF THE *AMICI CURIAE*

The National Governors' Association and the State of Hawaii, pursuant to Rule 36.2 of the Rules of the Supreme Court of the United States, submit this brief as *amici curiae* in support of the *Appellee* Franchise Tax Board. General consent to the filing of *amici curiae* briefs, whether in support of the *appellant* or *appellee*, has been granted by each of the parties, and the letters of the parties evidencing such consent are lodged in the Office of the Clerk of this Court.

Amicus National Governors' Association is an incorporated instrumentality of the States, whose members are the chief elected officials of the fifty States, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, and the territories of the Virgin Islands, Guam and American Samoa. The National Governors' Association files this *amici* brief on behalf of all its members, and is specifically joined by the State of Hawaii.

There are thirteen States[1] which presently utilize the unitary apportionment method of State income taxation of multinational corporations with foreign subsidiaries on a world-wide basis. A number of other States are contemplating its use and are awaiting the decision of this Court in the instant case and in the case of *Chicago Bridge & Iron Company v. Caterpillar Tractor Co., et al.*, Docket No. 81-349 (October Term 1981 but restored to the calendar for reargument). The Multistate Tax Commission has found that a prohibition on the inclusion of foreign subsidiaries in the definition of a unitary multinational corporation would result in a loss of State revenues of not less than $625 million per year.[2]

A loss in State revenues could not come at a worse time. During fiscal year 1981 total State expenditures

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[1] The thirteen States are Alaska, California, Colorado, Idaho, Illinois, Indiana, Massachusetts, Montana, New Hampshire, New York, North Dakota, Oregon and Utah. G.A.O. Report to the Chairman, House Committee on Ways and Means: Key Issues Affecting State Taxation of Multijurisdictional Corporate Income Need Resolving, p. 31.

[2] Summary of State Responses to Treasury Department Questionnaire on Use of Unitary Method and Taxation of Dividend Income, Multistate Tax Commission, Washington, D.C. (May 11, 1982). The figures were the official estimates of the affected responding State tax departments. The figures do not include losses to Illinois, Indiana, Massachusetts, New Hampshire and Oregon. They also do not include losses due to increased transfer pricing or greater losses from foreign business expansion in future years.

exceeded revenues by a little over $5 billion. States made up the difference by drawing down balances from prior years. As a result, States finished the year with an aggregate balance of 4.5 percent, a figure less than 5 percent of expenditures, which some observers consider the financially prudent level. In fiscal year 1982 it was estimated that expenditures would again outstrip revenues, drawing down balances by about $4 billion, leaving an aggregate balance of 1.5%. For fiscal year 1983 it is estimated that deficits amounting to $1.8 billion will accrue, leaving the year-end balance at 1.1% of current year expenditures.[3] With an aggregate balance down to $2.4 billion, it will be impossible for States to repeat their FY 1982 performance of drawing down balances of over $4 billion. As a result, even without a loss from a possible prohibition on the world-wide application of "unitary" with regard to multinational corporations having foreign subsidiaries, many States face expenditure reductions, revenue increases or both to maintain budget balances.[4] The decreasing States' balances are dramatic. The number of State working days that could be funded from year ending balances, averaged for all States, has decreased from 11 days in fiscal year 1981 to 4 days in fiscal year 1982 to 3 days in FY 1983.[5]

The present recession, high unemployment rates, high interest rates, and high business failure rates have all contributed to putting substantial pressure on the finances of State governments. High unemployment and

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[3] *Fiscal Survey of the States, 1981-1982.* National Governors' Association and the National Association of State Budget Officers, Washington, D.C. (1982), p. 4. The 1981-1982 report is the eighth volume in the annual *Fiscal Survey of the States.*

[4] All States except Vermont have legal constraints against incurring deficits in their general operating budgets, and Vermont, like other states, has strong traditions favoring a balanced budget.

[5] *Ibid.* at p. 8.

slow wage growth adversely affect income tax receipts and at the same time increase pressures for additional spending for income support programs. The drop in farm income has adversely affected revenues in States where a high proportion of economic activity is related to agriculture, a good number of which are "unitary" States. Changes in federal tax law that were enacted last year [6] continue to affect negatively State finances and will do so throughout the 1980's. Federal budget cuts are also having a major impact on State revenues. Federal aid to State and local governments has been going down. Federal outlays peaked in fiscal year 1981, and in constant dollar terms crested in fiscal year 1978.[7] Long-term projections show a continuation of the downward trend.

At the same time State budgets have been under considerable financial strain, States are being asked under "New Federalism" to assume a greater amount of responsibility for programs once administered by the federal government. In 1981 Congress, as part of the "Omnibus Budget Reconciliation Act of 1981," [8] enacted nine block grants.[9] In his 1982 budget message, President Reagan called for the devolution of 44 federal programs to be ad-

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[6] P.L. 97-34 entitled "The Economic Recovery Tax Act of 1981."

[7] See Addendum A. The National Governors' Association is the source of this chart. It is based on *The Budget of the United States Government, 1983, Special Analysis H, Federal Aid to State and Local Governments*, Office of Management and Budget, Executive Office of the President (February 1982); and Congressional Budget Office estimates.

[8] H.R. 3982, 97th Cong., 1st Sess. (1981), enacted as P.L. 97-35.

[9] Those nine block grants are: a) Alcohol, Drug Abuse and Mental Health Block Grant, b) Community Development Block Grant, c) Community Services Block Grant, d) Elementary and Secondary Education Block Grant, e) Home Energy Assistance Block Grant, f) Maternal and Child Health Care Block Grant, g) Preventive Health Services Block Grant, h) Primary Care Block Grant, and i) Social Services Block Grant.

ministered by the States.[10] Clearly, if States are to have the financial capacity to assume the turnback of greater program responsibilities from the federal government, States must have the resource base to pay for those programs.

The National Governors' Association is concerned with preserving the State income tax revenue base. That concern is reflected in the membership adopted policy position B.-5 entitled "Avoiding Federal Preemption of State Laws and Policies." It reads in part:

> The Constitution assigns certain responsibilities to the federal government and reserves the balance for the states. Accordingly, the role of the federal government in areas reserved for states and local governments should be strictly limited. . . .
>
> Integral to the operation of state government is the freedom to structure state revenue systems. It is essential that the federal government not preempt, either directly or indirectly, sources of state revenues, state tax bases or state taxation methods.[11]

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[10] *Budget of the United States Government, Fiscal Year 1983*, Office of Management and Budget, Executive Office of the President (February 1982), pp. 3-28 through 3-31; and *Major Themes and Additional Budget Details, Fiscal Year 1983*, Office of Management and Budget, Executive Office of the President (February 1982).

[11] National Governors' Association Policy Position B.-5 was adopted in August 1980 and amended in August 1982. The text accompanying and supporting the 1982 amendment read:

> This proposed policy position would amend existing NGA policy on federal preemption to clarify that NGA's position includes protection of a state's authority to structure its own revenue system. Existing NGA policy position B.-5 provides generally that federal preemption should be avoided. It does not reference state taxation. While NGA has relied on the general preemption language in the past, specific policy language would be helpful to NGA in addressing such revenue issues as the proposed increases in federal excise taxes, the imposition of federal minimum corporate and individual taxes affecting the

In furtherance of the National Governors' Association policy on preemption, and to retain the States' option to utilize on a world-wide basis the "unitary apportionment method" of taxing multinational corporations with foreign subsidiaries, Governor Alexander on behalf of the Association wrote to the President on February 25, 1982 [12] seeking the withdrawal by the Solicitor General of the federal government's brief in the *Chicago Bridge and Iron* case [13] and the Administration's opposition to H.R. 1983 and S. 655.[14] The matter was pursued further by Governor Snelling who wrote to the President on August 3, 1982 [15] prior to the meeting of the President's Cabinet Council on Economic Affairs at which the "unitary apportionment method" was to be discussed. Subsequent to the meeting of the Cabinet Council on Economic Affairs held on August 6, 1982, Richard S. Williamson, Assistant to the President for Intergovernmental Affairs, announced on August 8, 1982 at the National Governors' Association annual meeting that the Administration was opposed to any amendment to the pending comprehensive tax bill,

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deductibility of state and local taxes and interest from tax exempt bonds, and the states' use of the unitary apportionment method.

The proposed policy position calls for neither an increase nor a decrease in federal or state revenues. Rather, it would permit states to continue to have the flexibility to choose appropriate sources of revenue and methods of obtaining it.

[12] See February 25, 1982 letter from Governor Lamar Alexander to the President (Attached hereto as Addendum B).

[13] *Chicago Bridge & Iron Company v. Caterpillar Tractor Co., et al.*, Docket No. 81-349 (October Term 1981 but restored to the Calendar for reargument).

[14] H.R. 1983, 97th Cong., 1st Sess. (1981) and S. 655, 97th Cong., 1st Sess. (1981).

[15] See August 3, 1982 letter from Governor Richard A. Snelling to the President (Attached hereto as Addendum C).

H.R. 4961,[16] which would prohibit the States' use of the "unitary apportionment method" and the Administration would take no position on H.R. 1983 and S. 655.[17] Significantly, at the Cabinet Council meeting no department represented requested a filing of an *amicus* brief in this case by the Solicitor General. Therefore, it is not surprising to note that an *amicus* brief from the Solicitor General is absent in this case.

The National Governors' Association, joined by the State of Hawaii, seeks to preserve to the States the right to fairly apportion income taxes among multinational concerns doing business in the States in return for the opportunities, benefits and protections those States have afforded or provided those corporations. To achieve this objective the National Governors' Association Committee on Legal Affairs recommended to the Association's Executive Committee that the Association file an *amicus curiae* brief on behalf of the *appellee* Franchise Tax Board.[18] The Executive Committee approved the filing of the brief.

The Association is also concerned with the impact of the recent Court decisions of *ASARCO, Inc. v. Idaho State Tax Commission*[19] and *F.W. Woolworth Co. v. Taxation and Revenue Department of the State of New Mexico*.[20] These decisions impose unreasonable and unrealistic Constitutional restrictions on the taxing powers of the States. They hamper their ability to tax realisti-

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[16] H.R. 4961, 97th Cong., 2nd Sess. (1982), enacted into law as P.L. 97-248 entitled the "Tax Equity and Fiscal Responsibility Act of 1982".

[17] See September 2, 1982 letter from Governor Richard W. Riley and Governor Christopher S. Bond to Richard S. Williamson (Attached hereto as Addendum D).

[18] See July 15, 1982 letter from Governor Allen I. Olson to Governor Richard A. Snelling (Attached hereto as Addendum E).

[19] —— U.S. ——, 50 U.S.L.W. 4962 (1982).

[20] —— U.S. ——, 50 U.S.L.W. 4957 (1982).

cally income from intercorporate dealings in, and ownership of, intangibles. These intangibles annually amount to tens of billions of dollars. Under these decisions, this income can be apportioned only in those circumstances where it is logically treated as the profits of the payors of the income. For this reason, these decisions undercut the ability of the States to tax this income at all, if they could otherwise reasonably do so by resort to local fictions, such as the legal or commercial domicile of the corporate owners of the intangibles. They further erode a reasonable application of the unitary business principle by unduly restricting what constitutes a unitary business to meet due process "combined reporting" standards. This is demonstrated by *appellant*'s reliance on these decisions to support its argument that it did not conduct a unitary business with its subsidiaries. If these decisions are not reconsidered and this Court should conclude in this case that world-wide combination is prohibited by the Commerce Clause, the States clearly will be unable to tax effectively and fairly the profits of large multinational corporates that can shift their profits through a myriad of affiliated corporations anywhere in the world. As a result, the National Governors' Association supports the States of Idaho and New Mexico in their petitions for rehearings in the aforementioned cases.[21]

SUMMARY OF ARGUMENT

The Court should employ the same standards for examining a State's use of the unitary apportionment method for determining the income earned within that State by a domestic multinational corporation, without regard to whether the corporation is involved in interstate or foreign commerce.

The *appellee's* application of the apportionment formula to *appellant* yielded a result that roughly approximated the corporation's income that related to its activities

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[21] See September 21, 1982 letter from Governor Allen I. Olson to Larry G. Looney and Fred Muniz (Attached as Addendum F).

within the State of California. The wage differentials in the countries in which *appellant* did business were consistent with the wage differentials found in the United States when the formula apportionment method was designed. The net effect of averaging the differences in wage rates in the countries in which *appellant* carried on its business is to reduce possible distortions in the application of that formula factor. The three factor formula further reduces the significance of disparities in any single factor.

If there was any multiple taxation, it resulted either from extraterritorial application of foreign countries' taxes or from conflicting taxing methods of the *appellee* and foreign countries. If it was the former, then *appellee* should be able to require that the domestic corporation bear its fair share of the State tax burden. If it was the latter, then this Court should accept some *de minimis* multiple taxation. To the extent any such overlapping of taxation is possible and should be prevented, the *appellant* should look to Congress and not this Court for remediation.

America's foreign policy permits States to apply the unitary apportionment method to domestic multinational corporations with foreign subsidiaries on a world-wide basis. International law does not address how a country should tax its domestic corporations. There is no international custom that establishes arm's length as the international legal standard. And there have been no international repercussions to the States' application of the unitary apportionment method to domestic multinational corporations. If a change is to be made to our extant foreign tax policy, the *appellant* should look to Congress for relief.

This Court should find that *appellee* violated neither the Due Process nor Commerce Clause, and, therefore, the Court should affirm the decision of the Court of Appeal of the State of California.

ARGUMENT

The issue of whether the States have the authority to require United States multinational corporations with foreign subsidiaries to pay their fair share of State tax burdens is the question before the Court. In the instant case the *appellee* Franchise Tax Board has applied the same unitary apportionment method to *appellant* that it and forty-two other States use in interstate commerce. The Court has repeatedly approved its application in interstate commerce and should approve its application to domestic multinational corporations in foreign commerce as well because the constitutional principles are indistinguishable.

1. The application of California's apportionment formula produces a fair allocation of *appellant's* income that is reasonably related to the *appellant's* activities conducted in California, and thereby yields a result well within the Court's due process standard.

In the nineteenth century States used apportionment formulas to allocate property fairly for the purpose of determining the appropriate amount of property taxes of multistate corporations. Not long after States began imposing corporate income taxes in the early part of the twentieth century, they began apportioning income of unitary businesses by formula. Initially, a single property factor comprised the ingredient of the formula. In the case of *Underwood Typewriter Company v. Chamberlain*,[22] decided in 1920, the Court found constitutional the apportionment of income of a domestic corporation based on a property allocation formula. In 1924 this Court in *Bass, Ratcliff & Gretton, Limited, v. State Tax Commission*[23] found that an apportionment of income of a foreign-owned corporation based on a formula with property as the single factor neither violated the due

[22] 254 U.S. 113 (1920).

[23] 266 U.S. 271 (1924).

process clause nor imposed an unconstitutional burden on foreign commerce. When, however, the Court found the application of the constitutionally valid formula with the single property factor had an unreasonable and arbitrary impact, it declared the circumstances worked an unconstitutional result.[24] To avoid future unreasonable applications, States developed and began using formulas with more than one factor. One of those formulas, and the one in most prevalent use today, is a three part formula comprised of property, payroll and sales factors. The formula based on these three factors has been consistently upheld by this Court since *Butler Brothers v. McColgan*[25] and most recently in *Mobil Oil Corporation v. Commissioner of Taxes of Vermont*[26] and *Exxon Corporation v. Wisconsin Department of Revenue*.[27]

The question, therefore, is not on the validity of the three part formula based on property, sales and payroll factors, but rather on the result of the application of the formula to *appellant*, a unitary corporation as determined by the California Court of Appeal and assumed *arguendo* by the *appellant*.

This Court has said that the application of formulary apportionment need only achieve a *rough approximation* of the corporation's income that is reasonably related to the activities conducted within the taxing State.[28] This Court, therefore, should uphold the application of the formula to *appellant* if the tax assessed is not out of all proportion to the business transacted in the State[29] and

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[24] *Hans Rees' Sons, Incorporated v. North Carolina*, 283 U.S. 123 (1931).

[25] 315 U.S. 495 (1942).

[26] 445 U.S. 425 (1980).

[27] 447 U.S. 207 (1980).

[28] *Ibid.* at p. 223 (emphasis added).

[29] *Hans Rees' Sons, Incorporated, op. cit.* at p. 135.

the application has not been proven by the taxpayer to lead to a grossly distorted result.[30]

The *appellant* attempted to show that the three part formula distorts the income attributed to California because wage rates are higher in California than in foreign countries. *Appellant* compared wage rates of Columbia and Venezuela, two developing countries with low wage rates in which it does business, with wage rates in the United States. While the wage rate differentials were significant in the examples of the two developing countries chosen, they are not very different from the wage differentials found in this country between 1900 and World War II, the period of time when the formula apportionment methods were devised. In 1900 the regional per capita income as a percent of the U.S. average varied from a low of 47.8% in the Southeast to a high of 162.9% in the Far West, a ratio of almost 1:4.[31] In terms of total yearly wages per wage earner in manufacturing establishments in 1909, South Carolina's average was $274 compared to $962 in Nevada, a ratio of about 1:3.5. In 1929 the extremes ranged from South Carolina's $659 to Wyoming's $1,646.[32] These large wage differentials have not persisted within the United States. Regional wage differences have lessened over time.[33] One should expect that large wage differentials between developed and developing countries will not be permanent and will also narrow over time as businesses increase operations in lower wage sites, thereby driving up labor costs. There is nothing inherent in foreign commerce to distinguish the

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[30] *Norfolk and Western Railway Company v. Missouri State Tax Commission*, 390 U.S. 317, 326 (1968).

[31] *Regional Growth, Historic Perspective*, Advisory Commission on Intergovernmental Relations, Washington, D.C. (June 1980), Table 1, p. 11.

[32] *Ibid.*, at pp. 132-133, Table A-15.

[33] *Ibid.*, at p. 45, Table 25.

early wage differentials in the United States from present wage differentials between developed and developing countries.

During the disputed tax years in question, *appellant* controlled 20 subsidiaries in Western Europe and Latin America.[34] In addition to subsidiaries in Columbia and Venezuela, it also controlled at least one subsidiary in Germany where according to *appellant's* brief it required $3.95 in payroll costs compared to $3.34 in payroll costs in the United States to produce $1.00 of net income.[35] From *appellant's* brief one can conclude that there was a wide range of wage scales in countries in which *appellant* was doing business, ranging from developing countries where wage rates were considerably lower to Western European countries where wage rates were higher than the United States. *Appellant* has not shown what distortion it claims is due to wage rate differentials in all parts of the world in which it conducts business.

The test of whether the application of the three factor apportionment formula so distorts the allocation of income of "unitary" *appellant* as to make its use unconstitutional should be an examination of how the application of the formula to the domestic corporation and all its foreign subsidiaries combined operates, not how it operates on one foreign subsidiary alone. Averaging wage costs among all of *appellant's* foreign subsidiaries produces a result well within constitutional standards. In a truly unitary enterprise, the differing economic values existing in varying geographic areas do not distort the apportionment.

Payroll expenditures is only one of the three factors in the formula for apportionment. The three factors operate synergistically. *Appellant* has the burden, there-

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[34] *Appellant's* brief, Appendix A at p. A-2.

[35] *Appellant's* brief at p. 18.

fore, of showing not only that one factor presents potential problems, but that the three factors working together distort the allocation of income so badly that it assesses *appellant* wholly out of proportion to business transacted in California. *Appellant* has not overcome that burden.

2. The Commerce Clause permits some overlapping in taxation of income.

In the instant case the *appellee* Franchise Tax Board utilized a fair and accepted method of apportioning income of unitary *appellant*.[36] As applied by *appellee*, the formula apportionment only related to the activities conducted in the State of California by *appellant*,[37] and it did not tax income earned in any other jurisdiction.

Appellant asserts in its brief that it filed returns and paid taxes in compliance with the laws of the respective countries in which it did business.[38] However, there is no indication whether the laws of those countries restrict their jurisdiction to the taxation of income based on activities conducted within their borders. This is more than an academic question since the United States, for example, asserts world-wide taxing jurisdiction under Internal Revenue Code § 61.[39] Thus, if any multiple taxation has occurred, it may be the result of foreign countries asserting jurisdiction to tax income which was earned in the State of California.[40] One or more of those

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[36] See *Mobil, supra* at footnote 26.

[37] See point 1 of the Argument.

[38] *Appellant's* brief at p. 25.

[39] The United States tries to minimize the opportunity for double taxation by having available for foreign tax payers a foreign tax credit system.

[40] "A country is free to adopt whatever rules of tax jurisdiction it chooses. This is true no matter how broad may be the reach of the resulting tax net." Norr, Jurisdiction to Tax and International Income, 17 Tax L. Rev. 431 (1962).

foreign countries may have taxed income earned in California even though multiple taxation resulted. According to Geoffrey John Harley:

> There is no domestic or international law, treaties aside, which holds double taxation to be legally impermissible. Subject to any constitutional constraints, a jurisdiction can tax as it chooses.[41]

If the present case is an instance of a foreign country taxing income earned in California and California taxing that same income, should California give way? We think not. California is well within its constitutional rights to tax income earned within its borders even if multiple taxation results because a foreign country has applied its tax extraterritorially. The Constitution confers no immunity from State taxation, and foreign commerce must bear its fair share of the State tax burden.

It may be that any multiple taxation that occurred as a result of California's use of the "unitary apportionment method" and a country's use of the "arm's length method" resulted either from clashes between the two systems or definitional differences. However, so long as the overlap is small, it represents a *de minimis* situation. This Court, as it expressed itself in *Moorman Manufacturing Co. v. Bair*,[42] clearly understands the problems which arise when two taxing authorities do not use identical rules for the division of income. These problems exist not only when the taxing methods are different, but when they are the same. Differences within similar systems extend from definitions, rates and concepts to the treatment afforded corporations which receive income from extra-territorial operations. These differences mean that there are usually two potential claims to tax—in the

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[41] Harley, *International Division of the Income Tax Base of Multinational Enterprise: A Treatise on the Unitary Business Concept*, Multistate Tax Commission (1981), p. 162.

[42] 437 U.S. 267 (1978).

instant case California and a foreign country. Even if both California and the foreign country had used the "unitary" method or both had used the "arm's length" method, a similar overlap might well have resulted. Therefore, the use of the "unitary" method with regard to the taxation of multinational corporations with foreign subsidiaries by California should not be in question.

The *Appellant* relies on *Japan Line, Ltd. v. County of Los Angeles*[43] for the principle that where a country, in that instance Japan, had the right to tax fully an instrument of foreign commerce, California's tax, a fair property apportionment tax, of that same instrumentality had to give way. However, in *Mobil* the Court was careful to distinguish the principles of property taxation from those of income taxation.[44] In the *Japan Line* case, Japan had fully taxed Japanese companies on instrumentalities utilized exclusively in foreign commerce; California was trying to levy a tax on those same instrumentalities. In the instant case California is attempting to tax neither instrumentalities of foreign commerce nor a foreign corporation. Rather, it is taxing a domestic entity incorporated in Delaware with headquarters in Illinois for income earned in California and with which California has nexus.

Appellant is wrong in relying on the *Japan Line* case. It should look to *Bass, Ratcliff & Gretton, Limited, v. State Tax Commission.*[45] Once the *appellant* is found to be a "unitary" corporation, the principles of *Bass* apply. In *Bass* this Court upheld New York State's apportionment of the entire income of an English corporation to determine the appropriate amount of income earned in New York. To apply *Japan Lines* to the instant case is to

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[43] 441 U.S. 434 (1979).

[44] 445 U.S. at p. 448.

[45] 266 U.S. 271 (1924).

overrule *Bass*,[46] which would eliminate a longstanding distinction this Court has made between taxation of instrumentalities of commerce and taxation of income.[47]

If the *Court* is not going to accept some *de minimis* overlap in taxing by two jurisdictions, then the Court must be willing to involve itself in extensive judicial rule-making.[48] If the Court is unwilling to establish a uniform rule of apportionment in the case of interstate commerce when it has jurisdiction over all the parties, why is it more willing to do so when one taxing authority is beyond the Court's reach? Even if it so desires, this Court does not have the power to establish an international uniform rule for the division of income to which all countries will agree.

This Court has said that in the case of the use of the "unitary apportionment method" of taxation of companies involved in interstate commerce, Congress is the right tribunal to which the parties should turn to achieve uniformity in formulas. Congress is also the proper forum to achieve uniformity in the case of foreign commerce. This Court said in *Moorman*:

> While the freedom of the States to formulate independent policy in this area may have to yield to an overriding national interest in uniformity, the content of any uniform rules to which they must subscribe should be determined only after due consideration is given to all the interests of all the affected States. It is clear that the legislative powers granted to Congress by the Commerce Clause of the Constitu-

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[46] This court cited *Bass* favorably only two years ago in *Mobil*, 445 U.S. at pp. 438 & 439, and only last term in *ASARCO, Inc. v. Idaho State Tax Commission*, —— U.S. ——, slip opinion at p. 12, footnote 14, and p. 21 (1982).

[47] See *Wheeling Steel Corp. v. Fox*, 298 U.S. 193, 202 (1936).

[48] See *Moorman, op. cit.*, 437 U.S. at p. 278.

> tion would amply justify the enactment of legislation requiring all States to adhere to uniform rules for the division of income. It is to that body and not this Court, that the Constitution has committed such decisions.[49]

Congress has not been passive or silent with regard to the case of the "unitary apportionment method" for taxing multinational corporations with foreign subsidiaries. It has had made explicit decisions to continue to permit States to utilize it. When the United States/United Kingdom tax treaty was debated in the Senate, the issue of applying combined reporting to unitary multinational corporations was raised. The Senate refused to ratify the treaty until Article 9(4) prohibiting the use of the "unitary apportionment method" was removed.[50] Presently H.R. 1983 and S. 655, which raise the same issue, are before the Congress.[51] It was raised this summer during the consideration of H.R. 4961.[52]

In summary, if multiple taxation has occurred, it may be the result either of foreign governments taxing income earned in California or of California and foreign countries having conflicting taxation methods. In either case, we contend that this Court is not the proper tribunal to remedy the problem. The Administration and Congress working together are the appropriate branches of government to resolve the political and international relations issues involved.

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[49] Ibid. at p. 280.

[50] See *Third Protocol to the 1975 Income Tax Convention with the United Kingdom of Great Britain and Northern Ireland, As Amended*, S. Exec. Rep. No. 96-5, 96th Cong., 1st Sess. (June 15, 1979).

[51] See footnote 14 *supra*.

[52] See footnotes 15, 16 and 17 *supra* and Addenda G, H & I.

3. The use by *appellee* of the unitary apportionment method does not affect the ability of the United States' Government to speak with one voice in its foreign relations.

The unitary formula apportionment method applied by the State of California does not contravene any specific United States treaty or statute; for if it had, *appellant* would have so argued. The gravamen of *appellant's* argument is that the employment of the unitary method is in conflict with general federal policy, and thereby prevents the United States from speaking with one voice.

However, the general policy of the federal government over the last sixty years has been to allow States to use the unitary apportionment method. The issue of whether to permit States to use "formula apportionment" in the foreign commerce context has been raised in court cases, legislation and treaties and always been explicitly resolved in favor of the States. In the case of *Bass*, the *appellant* English firm of Bass, Ratcliff & Gretton argued that the application of formula apportionment to it constituted a burden on foreign commerce.[53] This Court rejected that theory.[54] It was also argued in Congress during the course of debate over numerous bills, the most recent of which were H.R. 1983, S. 655 and H.R. 4961.[55] The Administration, Congress and the States have all been involved in those debates.[56] No bill restricting the

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[53] 266 U.S. 271 (1924), Appellant's brief at p. 39.

[54] 266 U.S. 271 (1924).

[55] See footnotes 14 and 16 *supra*.

[56] See Addendum B; Addendum C; and Addendum D. Also see July 19, 1982 letter from Governor Richard A. Snelling to the Honorable Dan Rostenkowski (Attached hereto as Addendum G); July 21, 1982 letter from Governor Scott M. Matheson to the Honorable Dan Rostenkowski (Attached hereto as Addendum H); July 20, 1982 letter from Representative Peter W. Rodino, Jr. and Representative Don Edwards to the Honorable Dan Rostenkowski (Attached hereto

States' authority to utilize unitary apportionment on a world-wide bases has been enacted. Finally, the question was raised not long ago in the context of the U.S./U.K. Treaty, and no restrictions on the States were included.[57]

Appellant and its *amici* supporters fall back on international law. They assert that States must forego the use of the unitary apportionment method in favor of the arm's length method which they claim is the uniform international standard. First, no treaty requires that a treaty signatory utilize the arm's length method to calculate the tax of its own domestic corporations, and the *appellant* cites none. Rather, to the extent international treaties deal with the arm's length method, they restrict the use of one nation's taxation methods as they apply to the second nation's domestic corporations.[58] In the instant case, the *appellee* State of California is employing the unitary method to determine the taxable income of an American, not a foreign corporation. Second, there is no international custom that establishes arm's length as the international standard. There is no international definition of "arm's length," there are no agreed upon administrative guidelines, and there is no uniformity of application.

The *appellant* and others speculate that the failure to speak with one voice could result in disputes and retaliation. However, foreign direct investment in the United

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as Addendum I); and September 10, 1982 letter from U.S. Secretary of Labor Raymond J. Donovan to Governor Richard Snelling (Attached hereto as Addendum J).

[57] See footnote 50 *supra*. No provision to limit the States' use of unitary has been included in a tax treaty since then.

[58] "Virtually every U.S. tax treaty contains a saving clause in which the United States reserves the right to tax its citizens without regard to treaty." *Income Tax Treaties* (J. Bischel ed. 1978) at p. 718.

States is up 58% in the last year alone.[59] No retaliation has occurred. And to the extent that foreign governments have addressed the State Department, their letters have concerned the application of the unitary apportionment method to U.S. subsidiaries of foreign companies not foreign subsidiaries of United States corporations, the case at issue.

The interest of foreign countries is focused upon their domestic corporations. In the case at issue California is taxing an United States corporation established in Delaware and headquartered in Illinois. The tax is not on any of the foreign subsidiaries, their minority shareholders or the governments of the nations in which they are doing business. As a result of California's tax there is no decrease in the foreign subsidiaries' equity or assets. Thus, there is no local impact from the perspective of the foreign governments.

If a change is to be made to our present foreign policy that permits the States to apply the unitary method to multinationals, it should be accomplished by Congress and the Administration to which the Constitution has given the responsibility for establishing foreign policy. Congress can weigh all the interests and arguments, evaluate the impact on different corporations and in a variety of circumstances, and choose an appropriate solution after a long deliberative process. This Court is limited to resolving some very complicated tax questions based only on the facts of the case before it.

This Court should not limit the fundamental right of the States to tax merely on the nebulous concept that the unitary apportionment method in some way prevents the federal government from speaking with one voice.

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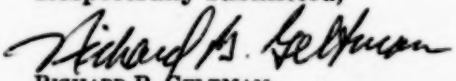
[59] Belli, R. David, "U.S. Business Enterprises Acquired or Established By Foreign Direct Investors in 1981," Survey of Current Business, Bureau of Economic Analysis, United States Department of Commerce (June 1982), p. 27.

CONCLUSION

If this Court finds that the *appellant* was conducting a unitary business enterprise, then your *amici* respectfully urge you to affirm the decision of the California Court of Appeal that the application of the unitary apportionment method to the *appellant* by the *appellee* Franchise Tax Board does not violate either the Due Process or Commerce Clause.

Dated at Washington, D.C. this 14th day of October, 1982.

Respectfully submitted,



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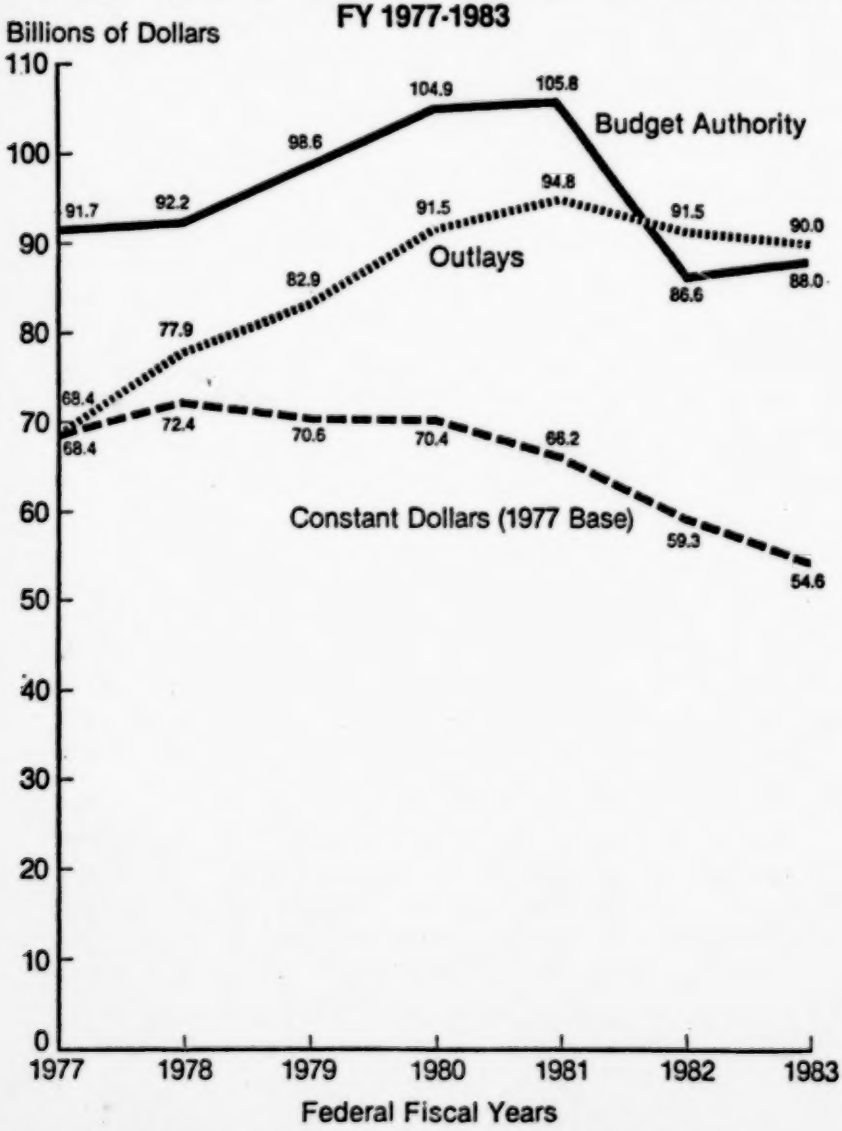
General Counsel

ADDENDUM A

FY 1983 First Budget Resolution

Federal Aid to State and Local Governments

FY 1977-1983



Source: National Governors' Association. Computation based on OMB Special Analysis H and CBO Estimates.

ADDENDUM B

NATIONAL GOVERNORS' ASSOCIATON

February 25, 1982

The President
The White House
Washington, D.C. 20500

Dear Mr. President:

Several Governors have expressed concern about a position taken by the Department of Justice against state revenue systems which incorporate the unitary tax method. In view of the serious nature of their concern, I am writing, as chairman of the committee of the National Governors' Association with jurisdiction over the issue, to ask for a review of the Department's action.

Chicago Bridge & Iron Company vs. Caterpillar Tractor Co., et al (Docket Number 81-349) is currently before the Supreme Court of the United States on appeal from the Illinois Supreme Court, which upheld Caterpillar's right to report its income for state tax purposes on a unitary accounting basis. The Department of Justice has recently filed an *amicus curiae* brief in this case against the states' ability to tax on a unitary basis. We believe that the Department's intervention is unnecessary and constitutes a serious federal infringement of the power of the states to tax as they choose.

For some time, the Governors have been concerned about federal restrictions on traditional state functions. In August 1980, the National Governors' Association adopted policy stating that "the principle of avoiding preemption by the federal government in areas of primary state responsibility is applicable across the board. . ." Clearly state taxation of our own citizens is such an area. Last fall, the Western Governors' Policy Office

urged your Administration to oppose legislative restrictions on the unitary method (S. 655/H.R. 1983), pointing out that they "would be inconsistent with efforts to sort out responsibilities and with the New Federalism."

If they prevail, the Department of Justice's position in the *Chicago Bridge & Iron* case and the proposed legislative restrictions will cause serious damage to our mutual efforts to restore balance to the federal system and to protect traditional state tax sources. In the short run, the legislation will cost 33 states a minimum of $709 million. In the years to come, all states would lose an important part of their ability to set their own fiscal policies.

We know that you are deeply committed to strengthening the state role in the federal system. We believe that the brief filed by the Department of Justice in this case and the proposed federal legislation are at substantial variance with your commitment. Accordingly, we respectfully request that this brief be withdrawn and that your Administration oppose S. 655 and H.R. 1983. Thank you for your consideration of our concerns.

Sincerely,

/s/ Lamar Alexander
GOVERNOR LAMAR ALEXANDER
Chairman, Committee on Executive
Management and Fiscal Affairs

ADDENDUM C

NATIONAL GOVERNORS' ASSOCIATON

August 3, 1982

The President
The White House
Washington, D.C. 20500

Dear Mr. President:

It is our understanding that the Cabinet Council on Economic Affairs will be meeting on Thursday, August 5 to discuss the Administration's position on state utilizaiton of the "unitary apportionment method" of taxation of multinational corporations. Governor Lamar Alexander, on behalf of the National Governors' Association, wrote to you on February 25, 1982 on this matter. At that time he requested that you join the National Governors' Association in opposing two pending Congressional bills, S. 655 and H.R. 1983, that would restrict states' ability to tax multinational corporations and that you have the Department of Justice withdraw the *amicus curiae* brief it filed in the case of *Chicago Bridge and Iron Company* v. *Caterpillar Tractor Company, et al.*, still pending before the Supreme Court of the United States.

I would like to reiterate the concerns expressed in Governor Alexander's letter. At a time when the states are being asked to assume significantly expanded responsibilities under New Federalism, we need access to appropriate revenue sources.

In our opinion the Constitutional question concerning the use of the "unitary apportionment method" of state taxation of multinational corporations and the taxation of intracorporate dividends is more a question of federalism than foreign commerce. Certainly one power reserved

to the states under the Tenth Amendment is the power to design a fair tax system. Absolutely integral to the functioning of a state government is its ability to raise revenues and provide incentives for economic development.

In utilizing the "unitary apportionment method", twenty-two states include domestic subsidiaries in their definition of a unitary business, and twelve states include foreign subsidiaries in that definition. These latter referenced twelve states have estimated that a prohibition on the inclusion of foreign subsidiaries would result in a loss of state revenues of not less than $600 million. For the thirty-eight states which do not include foreign-based subsidiaries in their definition of the taxable corporation, the omission has been used as a state inducement for economic investment and development by foreign corporations. It is the position of the National Governors' Association that states should continue to have the choice to include foreign subsidiaries within their definition of unitary corporation in utilization of the "unitary method of apportionment" on a world-wide basis.

When the National Governors' Association meets in Oklahoma next week, it will be considering a revision to an extant policy position in order to address more directly the question of federal preemption of state revenue systems. One reason for the proposed policy revision is the controversy over state taxation of multinational corporations. The Committee on Executive Management and Fiscal Affairs chaired by Governor Alexander, with the support of the Committee on Community and Economic Development chaired by Governor Bond, has proposed the following amendment to policy position B.-5 entitled "Avoiding Federal Preemption of State Laws and Policies":

> Integral to the operation of state government is the freedom to structure state revenue systems. It is essential that the federal government not preempt,

either directly or indirectly, sources of state revenues, state tax bases or state taxation methods.

In light of the above discussion, we respectfully ask that you support a position which will permit states to: a) utilize the "unitary method of apportionment" with regard to multinational corporations which have foreign subsidiaries, and b) tax intracorporate dividends of multinational corporations.

Thank you for your attention to this matter.

Sincerely,

/s/ Richard A. Snelling
GOVERNOR RICHARD A. SNELLING

cc: Secretary Donald T. Regan, Chairman pro tempore
Cabinet Council on Economic Affairs

ADDENDUM D

NATIONAL GOVERNORS' ASSOCIATON

September 2, 1982

Mr. Richard S. Willamson
Assistant to the President for
Intergovernmental Affairs
The White House
1600 Pennsylvania Aveune, N.W.
Washington, D.C. 20500

Dear Rich:

We especially appreciate your participation in the joint session of the Committee on Community and Economic Development and the Committee on State-Local Relations at the National Governors' Association and annual meeting.

All the governors value the support we have received from your office, particularly with regard to such tax questions as the preservation of the deductibility of state and local taxes and the tax exemption of interest from municipal bonds, and opposition to increases in the gas tax.

You showed a great sensitivity to our concerns during the meeting. Let us say at the outset on behalf of the National Governors' Association, we accept your offer to begin consultation with the Administration earlier in the federal budgetary process commencing with the FY 1984 budget cycle. In addition, we wish to acknowledge our recognition of three very significant announcements that you made that are important to us and were well received. First, we were pleased that you announced the Administration supported the Senate passed version of the comprehensive tax bill, H.R. 4961, and would oppose any further restrictions on industrial revenue bonds. Second, we

were further gratified that you announced that the Presiednt had decided to oppose the Public Employee Retirement Income Security Act (PERISA) legislation, which state and local officials have opposed as unnecessary, intrusive and contrary to the President's federalism initiative. And finally, you said that the President's Cabinet Council on Economic Affairs had met and decided a) that the Administration was opposed to any amendment to H.R. 4961 which would prohibit the states' use of the "unitary apportionment method" of taxing multinational corporations with foreign subsidiaries, and b) that the Administration would take no position at this time on H.R. 1983 and S. 655, which deal with the "unitary" multinational corporations.

Thank you again for participating in our joint session and articulately setting out the Administration's views on federalism, budget, and tax matters.

Sincerely,

/s/ Dick Riley
GOVERNOR RICHARD W. RILEY
Chairman, Committee on
State-Local Relations

/s/ Christopher S. Bond
GOVERNOR CHRISTOPHER S. BOND
Chairman, Committee on
Community and Economic Development

cc: All Governors

ADDENDUM E

NATIONAL GOVERNORS' ASSOCIATON

July 15, 1982

The Honorable Richard A. Snelling
Chairman
National Governors' Association
444 North Capitol Street
Washington, D.C. 20001

Dear Mr. Chairman:

I am writing to you in my capacity as chairman of the Legal Affairs Committee of the National Governors' Association to report the conclusion and recommendation of the Committee in the case of *Container Corporation of America v. Franchise Tax Board*, a case in which the Supreme Court of the United States has noted probable jurisdiction, Docket Number 81-523. The Committee has reviewed relevant documents concerning the above-styled case as well as material concerning the case of *Chicago Bridge and Iron Co. v. Caterpillar Tractor Co.*, a similar case before the Court which has been set for reargument on the Court's next term calendar.

It is our conclusion that *Container Corporation of America* involves important federal constitutional questions relating to whether a state's use of the unitary apportionment method of taxing a domestic corporation with foreign subsidiaries is consistent with the due process and foreign commerce clauses of the United States Constitution. The outcome of the appeal in this case may have a significant effect on federal-state relations, the ability of states to choose their own taxation methods, and the collection of over $600 million in state taxes.

The Legal Affairs Committee recommends that the staff of the National Governors' Association take appropriate

action to file an *amicus curiae* brief on behalf of the *appellee* Franchise Tax Board.

Feel free to call upon me if you have any questions about our recommendations.

Sincerely,

/s/ Allen I. Olson
ALLEN I. OLSON
Governor

cc: Members of the Legal Affairs Committee
Governor Edmund G. Brown, Jr.

ADDENDUM F

NATIONAL GOVERNORS' ASSOCIATON

September 21, 1982

Mr. Larry G. Looney, Commissioner
Taxation & Revenue Department
P.O. Box 26
Boise, Idaho 83722

Mr. Fred Muniz, Secretary
Taxation and Revenue Department
P.O. Box 630
Santa Fe, New Mexico 87509

Dear Commissioner Looney and Secretary Muniz:

The National Governors' Association, representing the elected chief executive officers of the fifty states, the Commonwealth of Puerto Rico, the Commonwealth of the Northern Mariana Islands, and the Territories of American Samoa, Guam and the Virgin Islands, is deeply concerned about two recent decisions of the Supreme Court of the United States: *ASARCO, Inc. v. Idaho Tax Commission* and *F.W. Woolworth Co. v. Taxation and Revenue Department of New Mexico.*

At its most recent annual meeting held in August of this year in Afton, Oklahoma, the Association promulgated an amendment to its policy position entitled "Avoiding Federal Preemption of State Laws and Policies". One of the reasons for this action by the Association was the two aforementioned decisions of the highest federal court and the pending cases of *Chicago Bridge and Iron Company v. Caterpillar Tractor Co. et al.*, Docket Number 81-349, and *Container Corporation of America v. Franchise Tax Board*, Docket Number 81-523, presently before the Court. The amendment reads as follows:

> Integral to the operations of state government is the freedom to structure state revenue systems. It is essential that the federal government not preempt, either directly or indirectly, sources of state revenues, state tax bases or state taxation methods.

The National Governors' Association supports your efforts to obtain rehearings of the *ASARCO* and *Woolworth* cases. In our opinion these two decisions could prevent any state from subjecting interstate business and multistate-multinational business to fair and uniform tax treatment and could result in massive losses of revenues to the states at a time when we are ill equipped to absorb any such losses. Furthermore, these decisions present potentially significant practical difficulties for taxpayers and state tax administrators alike in determining the proper method for filing returns on a yearly basis.

It is our belief that it is essential for the Supreme Court of the United States to grant your petitions for rehearing and reconsider both the impact the decisions will have on federalism and clarify the ambiguities the initial decisions presented.

Sincerely,

/s/ Allen I. Olson
GOVERNOR ALLEN I. OLSON
Chairman, Committee on
Legal Affairs

ADDENDUM G

NATIONAL GOVERNORS' ASSOCIATON

July 19, 1982

The Honorable Dan Rostenkowski
Chairman
House Ways and Means Committee
1102 Cannon House Office Building
Washington, D.C. 20515

Dear Mr. Chairman:

Integral to our federal system and the operation of state government is the freedom to structure state revenue systems. The Governors seek your strong support for this principle of federalism. As the Ways and Means Committee begins markup of the 1982 tax bill we urge the Committee not to preempt, either directly or indirectly, sources of state revenues, state tax bases, or state taxation methods.

In particular, we urge the Committee not to include in the tax bill: 1) minimum tax provisions that adversely impact the municipal bond market; 2) excise tax increases that would preempt future state increases in those taxes; 3) unreasonable restrictions on industrial revenue development bonds; and 4) any restrictions on state taxation of multinational corporations. The last issue is currently pending before the Supreme Court, and hearings have not yet been held in this Congress.

We are partners in a unique system of government that transcends specific measures to reduce the deficit, balance the budget, and raise federal revenues. Federalism will work only if it is based on a mutually acceptable fiscal federalism. We are prepared to consult and cooperate with the Committee on tax matters to insure that

each level of government has the revenue sources to carry out its responsibilities.

Sincerely,

/s/ Richard A. Snelling
GOVERNOR RICHARD A. SNELLING

cc: Members of the Committee

ADDENDUM H

[SEAL]

STATE OF UTAH

OFFICE OF THE GOVERNOR
Salt Lake City
84114

July 20, 1982

The Honorable Dan Rostenkowski
Chairman
House Ways & Means Committee
2111 Rayburn Office Building
Washington, D.C. 20515

Dear Chairman Rostenkowski:

I understand that a proposal may be offered in the House Ways and Means Committee sometime this week which would restrict the States' taxing authority.

As incoming Chairman of the National Governors' Association I join with Governor Richard Snelling, current Chairman, in expressing my deep concern over any effort to limit taxing methods and policies employed by one or more of the States.

At the November, 1981 meeting of the Western Governors Policy Office (WESTPO) the member Governors reviewed legislation similar to the language we understand may be proposed in Committee. The bi-partisan group of Western Governors unanimously adopted the following position:

> We affirm our support for the states' right, guaranteed under the Constitution to levy taxes to support important public services. . . . We believe that any federal legislation or other effort that would re-

strict, direct, or diminish state taxation policies, methods or laws would be inconsistent with efforts to sort out responsibilities (between the States and the Federal Government) and with the New Federalism. In addition, it would represent a serious abuse of the Doctrine of States' Rights. We oppose new federal restrictions on state taxation.

It is especially vital to maintain traditional and constitutionally derived State taxing authority as State's are called upon to assume additional responsibilities under a federalism initiative.

I appreicate your attention to this matter and urge your Committee to reject amendments which would circumscribe States' taxing authority.

Sincerely,

/s/ Scott M. Matheson
SCOTT M. MATHESON
Governor

ADDENDUM I

CONGRESS OF THE UNITED STATES

COMMITTEE ON THE JUDICIARY

House of Representatives
Washington, D.C. 20515
Telephone: 202-225-3951

July 20, 1982

Honorable Dan Rostenkowski
Chairman
Committee on Ways and Means
House of Representatives
Washington, D.C. 20515

Dear Mr. Chairman:

It is our understanding that your committee may be asked during a mark-up session to consider a proposal to limit or deny the States' use of the unitary apportionment accounting method by which they arrive at the tax liability of multinational corporations doing business within their borders.

As you know, questions involving the rights of the States traditionally, as well as under the Standing Rules of the House of Representatives, have been considered to be within the jurisdiction of the Committee on the Judiciary. Indeed, the Judiciary Committee has considered in the past proposals similar to that which we understand will be offered in your mark-up.

It is our view that the specific effort to amend the Internal Revenue Code in regard to the taxing authorities of the States raises serious, grave and far-reaching Constitutional questions. So serious are these questions with regard to this specific issue that we believe it would require that hearings be held to consider the views of the

nation's Governors, Constitutional specialists and corporations and to update hearings held many years ago by the House Committee on the Judiciary.

Of course, we wish to cooperate fully with the Commitee on Ways and Means. Nevertheless, we believe the Constitutional issues raised and the jurisdictional situation to be so serious with regard to this proposal that we want to advise you of our intention to assert our jurisdiction over any effort by the Ways and Means Committee to limit State taxing authority.

Sincerely,

/s/ Peter W. Rodino, Jr.
Chairman
House Committee on the Judiciary

/s/ Don Edwards
DON EDWARDS
Chairman, Subcommittee
on Civil and Constitutional
Rights

ADDENDUM J

U.S. DEPARTMENT OF LABOR

SECRETARY OF LABOR
Washington, D.C.

Sep. 10, 1982

Honorable Richard Snelling
Governor of Vermont
Chairman
National Governors' Association
444 North Capital Street
Washington, D.C. 20001

Dear Governor Snelling:

I recently received a cover copy of your letter to the President concerning state use of the "unitary apportionment method" of taxation of multi-national corporations. I appreciate your letter because this has been a difficult and controversial issue within the Administration in terms of balancing the foreign policy concerns with the tenets of the New Federalism.

As you know, there are bills pending in both the House and the Senate which would outlaw this method of taxation (H.R. 1983 and S.655). However, legislative action may be moot if the method is declared unconstitutional by the Supreme Court in the pending case *Chicago Bridge & Iron Co. v. Caterpillar Tractor Co., et al.* We are continuing to study the issue, but due to the possible constitutional basis of a Supreme Court decision, we decided it would be wise to wait for the Court to rule before taking a position on the legislation.

I appreicate your views on the matter and will give them careful consideration.

Sincerely,

/s/ Raymond J. Donovan
RAYMOND J. DONOVAN